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CONTRACT MANAGEMENT

Trends and Challenges in Acquiring Services

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Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to participate in the Subcommittee's hearing on the challenges confronting the government's acquisition of services. Federal agencies spend billions of tax dollars each year to buy services ranging from clerical support and consulting services, to information technology services such as network support, to the management and operation of government facilities, such as national laboratories. The amount being spent on services is growing substantially. Last year alone, the federal government acquired more than $87 billion in services—a 24-percent increase in real terms from fiscal year 1990.

Our work continues to show that some service procurements are not being done efficiently, putting taxpayer dollars at risk. In particular, agencies are not clearly defining their requirements, fully considering alternative solutions, performing vigorous price analyses, and adequately overseeing contractor performance. Further, it is becoming increasingly evident that agencies are at risk of not having enough of the right people with the right skills to manage service procurements. Consequently, a key question we face in the government is whether we have today, or will have tomorrow, the ability to acquire and manage the procurement of increasingly sophisticated services the government needs.

My statement today will

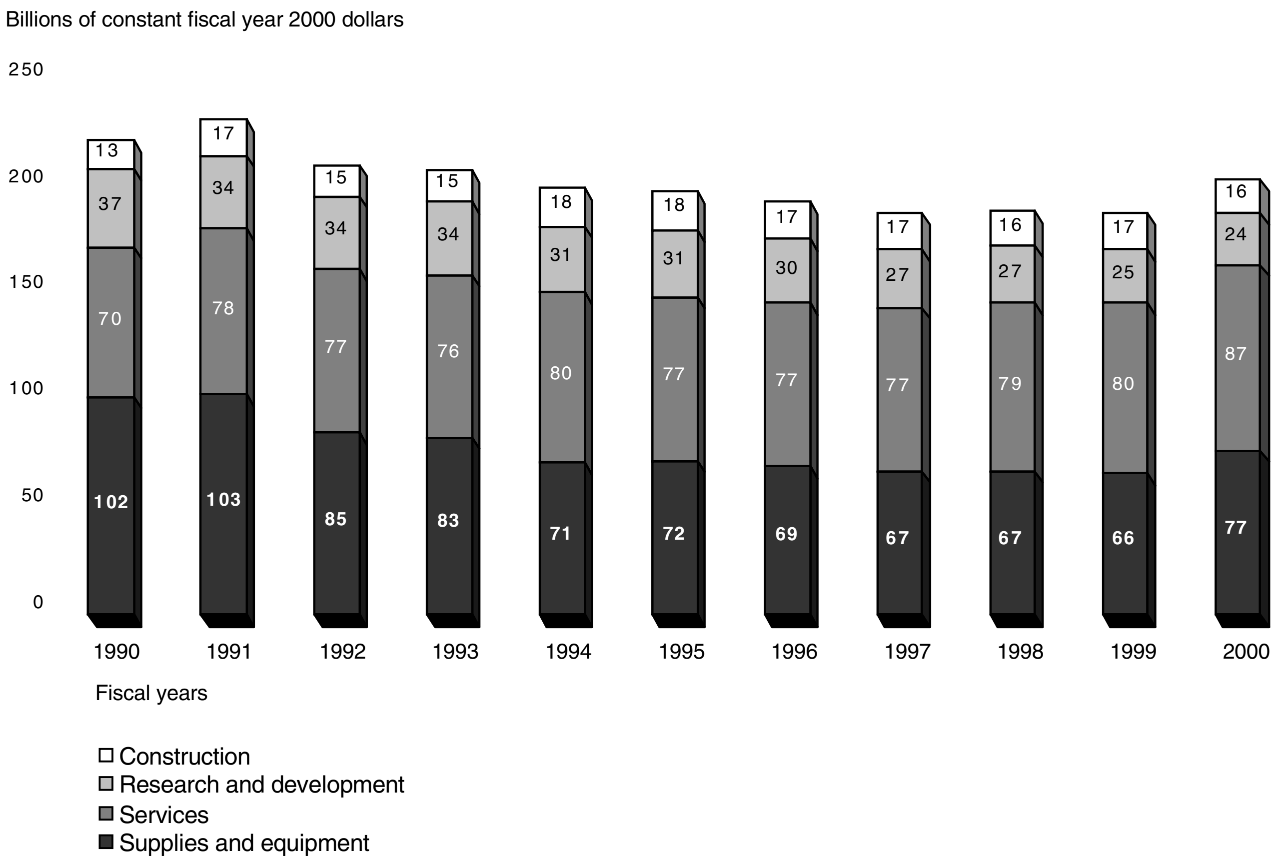
- describe service contracting trends and the changing acquisition environment,
- discuss the challenges confronting the government in acquiring services, and
- highlight some efforts underway to address these challenges.

Trends in Service Contracting and the Changing Acquisition Environment

Federal contracting began declining in the late 1980s as the Cold War drew to a close and defense spending decreased. This decline in federal contracting continued for most of the 1990s, reaching a low of about $187 billion[1] in fiscal year 1999. Spending subsequently increased to about $204 billion in fiscal year 2000. As figure 1 shows, between fiscal year 1990 and fiscal year 2000, purchases of supplies and equipment fell by about $25 billion, while purchases of services increased by $17 billion, or about 24 percent. Consequently, purchases for services now account for about 43 percent of federal contracting expenses—the largest single spending category.

[1] All dollars figures used in this section have been converted to constant fiscal year 2000 dollars. Additionally, the figures exclude actions under $25,000 and those made by government purchase cards.

Figure 1: Changes in Federal Contract Spending, Fiscal Year 1990 to Fiscal Year 2000



Source: GAO analysis of data extracted from the Federal Procurement Data System for actions exceeding $25,000.

The growth in services has largely been driven by the government's increased purchases of two types of services:

- information technology services, which increased from $3.7 billion in fiscal year 1990 to about $13.4 billion in fiscal year 2000; and
- professional, administrative, and management support services, which rose from $12.3 billion in fiscal year 1990 to $21.1 billion in fiscal year 2000.

The increase in the use of service contracts coincided with a 21-percent decrease in the federal workforce,[2] which fell from about 2.25 million employees as of September 1990 to 1.78 million employees as of September 2000.

As federal spending and employment patterns were changing, changes were also occurring in the way that federal agencies buy services. Specifically, there has been a trend toward agencies purchasing professional services using contracts awarded and managed by other agencies. For example, in 1996, the General Services Administration (GSA) began offering information technology services under its Federal Supply Schedule program,[3] and it now offers services ranging from professional engineering to laboratory testing and analysis to temporary clerical and professional support services. The use of the schedule program to acquire services has increased significantly over the past several years.

Other governmentwide contracts have also come into use in recent years. The Federal Acquisition Streamlining Act of 1994 authorized federal agencies to enter into multiple award, task- and delivery-order contracts for goods and services. These contracts provide agencies with a great deal of flexibility in buying goods or services while minimizing the burden on government contracting personnel to negotiate and administer contracts. The Clinger-Cohen Act of 1996 authorized the use of multiagency contracts and what have become known as governmentwide agency contracts to facilitate purchases of information technology-related products and services such as network maintenance and technical support, systems engineering, and integration services.

[2] Reflects the total civilian employment for executive branch agencies, excluding the U.S. Postal Service and the Postal Rate Commission.

[3] Under the schedule program, GSA negotiates contracts with vendors for a wide variety of mostly commercial-type products and services, and permits other agencies to place orders under these contracts directly with the vendors. Traditionally, the program had generally been used for common goods, such as office supplies and furniture. According to GSA, it takes 268 days to award a contract using traditional methods, but it takes only 15 days, on average, to award an order under the schedule program.

Challenges Faced by the Government In Acquiring Services

While we have seen the environment change considerably, what we have not seen is a significant improvement in federal agencies' management of service contracts. Put simply, the poor management of service contracts undermines the government's ability to obtain good value for the money spent. This contributed to our decision to designate contract management a high-risk area for the Departments of Defense and Energy, the two largest purchasers within the federal government. Improving contract management is also among the management challenges faced by other agencies. Compounding these problems are the agencies' past inattention to strategic human capital management. As you may know, in January 2001, we designated strategic human capital management a governmentwide high-risk area.

Our work, as well as work by other oversight agencies, continues to identify examples of long-standing problems in service contracting, including poor planning, inadequately defined requirements, insufficient price evaluation, and lax oversight of contractor performance. For example,

- We found that the Department of Defense's (DOD) broadly defined work descriptions for information technology services orders placed against several governmentwide contracts prevented establishing firm prices for the work.[4] Work descriptions defined services broadly because the orders covered several years of effort, and officials were uncertain what support they would need in future years. The 22 orders we reviewed—with a total value of $553 million—typically provided for reimbursing the contractors' costs, leaving the government bearing most of the risk of cost growth. Further, although competition helps agencies ensure they obtain the best value under contracts, a majority of these orders were awarded without competing proposals having been received.
- The DOD Inspector General found problems with each of the more than 100 contract actions—with a total value of $6.7 billion—for professional, administrative, and management support services it reviewed.[5] For example, contracting officials typically did not use experience from prior acquisitions of the same services to help define requirements more clearly. In one case, officials continued to award cost reimbursement contracts—

[4] *Contract Management: Few Competing Proposals for Large DOD Information Technology Orders* (GAO/NSIAD-00-56, Mar. 20, 2000).

[5] *Contracts for Professional, Administrative, and Management Support Services* (Office of the Inspector General, Department of Defense, Mar. 10, 2000).

and accepted the risk of cost overruns—despite 39 years of experience purchasing the same services from the same contractor. Further, officials typically did not prepare well-supported independent cost estimates to help them assess whether the costs contractors proposed were reasonable. Finally, the Inspector General found that oversight of contractor performance was inadequate in a majority of cases, and in some cases DOD officials could not show that they had actually reviewed the contractors' work.

- We found that DOD personnel sought competing quotes from multiple contractors on only a handful of orders for information technology services placed against GSA's federal supply schedule contracts.[6] On 17 orders—valued at $60.5 million—contracting officers generally compared the labor rates offered by their preferred contractor with labor rates of various other contractors' supply schedule contracts instead of seeking competing quotes. This limited analysis did not provide a meaningful basis for assessing whether a contractor would provide high-quality, cost-effective services because it did not evaluate the proposed number of labor hours and mix of labor skill categories. Therefore, contracting officers' ability to ensure that DOD got the best services at the best prices was significantly undermined.
- The Inspector General at the Department of Transportation found that on an $875-million contract for technical support services, the Federal Aviation Administration did not develop reliable cost estimates or use these estimates to assess whether costs the contractor proposed were reasonable.[7] Further, the agency generally did not gather data to evaluate the quality of contractor performance nor ensure that contractor personnel had the education and experience required for the jobs they were being paid to perform.
- The Inspector General at the Department of Energy reported on a $218-million contract for security services at its Oak Ridge operations.[8] This contract was intended to consolidate security services under a single contractor and to reduce costs by reducing staffing and eliminating duplicative management structures. Oak Ridge officials, however, did not

[6] *Contract Management: Not Following Procedures Undermines Best Pricing Under GSA's Schedule* (GAO-01-125, Nov. 28, 2000).

[7] *Technical Support Services Contract: Better Management Oversight and Sound Business Practices Are Needed* (Office of the Inspector General, Department of Transportation, Sept. 28, 2000).

[8] *The Restructure of Security Services by the Oak Ridge Operations Office* (Office of the Inspector General, Department of Energy, Oct. 31, 2000).

define what security-related work the new contractor would perform and did not analyze staffing levels or propose cost reduction measures to promote efficient contractor performance. Consequently, the number of security personnel actually increased from 640 prior to the consolidation to 744 afterwards, while Oak Ridge incurred an estimated $7.5 million in avoidable costs instead of achieving an anticipated $5 million in savings.

While these examples highlight the need for federal agencies to improve their management of service contracts, their capacity to do so is at risk because of past inattention to strategic human capital management. We are concerned that federal agencies' human capital problems are eroding the ability of many agencies—and threaten the ability of others—to perform their missions economically, efficiently, and effectively. For example, we found that the initial rounds of downsizing were set in motion without considering the longer term effects on agencies' performance capacity. Additionally, a number of individual agencies drastically reduced or froze their hiring efforts for extended periods. Consequently, following a decade of downsizing and curtailed investments in human capital, federal agencies currently face skills, knowledge, and experience imbalances that, without corrective action, could worsen given the number of current federal civilian workers that are eligible to retire through 2005.

I would like to use DOD's experience to illustrate this problem. As we recently testified,[9] DOD's approach to civilian workforce reduction was not oriented toward shaping the makeup of the force. Rather, DOD relied primarily on voluntary turnover and retirements, freezes on hiring authority, and its authority to offer early retirements and "buy-outs" to achieve reductions. As a result, DOD's current workforce is not balanced and therefore risks the orderly transfer of institutional knowledge. According to DOD's Acquisition 2005 Task Force,[10] 11 consecutive years of downsizing produced serious imbalances in the skills and experience of the highly talented and specialized civilian acquisition workforce, putting DOD on the verge of a retirement-driven talent drain.

[9] *Human Capital: Major Human Capital Challenges at the Departments of Defense and State* (GAO-01-565T, Mar. 29, 2001).

[10] *Shaping the Civilian Acquisition Workforce of the Future* (Final Report of the Acquisition 2005 Task Force to the Under Secretary of Defense, Acquisition, Technology, and Logistics and the Under Secretary of Defense, Personnel and Readiness, Oct. 2000).

DOD's leadership had anticipated that using streamlined acquisition procedures would improve the efficiency of contracting operations and help offset the effects of workforce downsizing. However, the DOD Inspector General reported that the efficiency gains from using streamlined procedures had not kept pace with acquisition workforce reductions. The Inspector General reported that while the workforce had been reduced by half, DOD's contracting workload had increased by about 12 percent[11] and that senior personnel at 14 acquisition organizations believed that workforce reductions led to problems such as less contractor oversight.

While I have discussed DOD's problems at length, we believe our concerns are equally valid regarding the broader civilian agency contracting community. For example, our analysis of personnel data maintained by the Office of Personnel Management (OPM) shows that while DOD downsized its workforce to a greater extent than the civilian agencies during the 1990s, both DOD and the civilian agencies will have about 27 percent of their current contracting officers eligible to retire through the end of fiscal year 2005. Consequently, without appropriate workforce planning, federal agencies could lose a significant portion of their contracting knowledge base.

Some Efforts are Underway to Address Service Contracting Challenges

Congress and the administration are taking steps to address some of these contract management and human capital challenges, in particular by emphasizing the increased use of performance-based service contracts and by stressing the importance of integrating strategic human capital management into agency planning.

Performance-based contracts describe desired outcomes rather than direct work processes.[12] According to the Office of Federal Procurement Policy, the use of performance-based contracts should result in lower prices and improved performance, among other benefits. To encourage their use, in April 2000, the Procurement Executives Council—a senior level coordinating body comprised of officials from more than 20 federal

[11] *DOD Acquisition Workforce Reduction Trends and Impacts* (Office of the Inspector General, Department of Defense, Feb. 29, 2000).

[12] A performance-based contract describes the government's requirements in terms of desired results and measurable outcomes, establishes procedures to manage performance that does not meet standards, and includes performance incentives where appropriate.

departments and agencies—established a goal that 50 percent of service contracts will be performance-based by fiscal year 2005. The goal of increasing the use of performance-based contracts was reaffirmed in a March 9, 2001, memorandum issued by the Office of Management and Budget (OMB). Further, as required by last year's defense authorization act,[13] the Federal Acquisition Regulation was revised on May 2, 2001, to establish a preference for using performance-based contracting when acquiring services.

While we support the use of performance-based approaches, it should be recognized that performance-based contracting is not a new concept. The Office of Federal Procurement Policy issued a policy letter in April 1991 that directed using performance-based contracting to the maximum extent practicable. However, this approach was not widely adopted by federal agencies, and the Procurement Executives Council's interim goal of having 10 percent of service contracts awarded in fiscal year 2001 be performance-based is indicative of the current level of performance-based contracting in the government. Consequently, the extent to which agencies provide the necessary training, guidance, and tools to their workforce, and establish metrics to monitor the results of the contracts awarded using performance-based approaches, will affect whether this effort achieves its intended results.

With regard to human capital management, it is clear that both OPM and OMB have substantial roles to play. OPM has begun stressing to agencies the importance of integrating strategic human capital management into agency planning and has focused more attention on developing tools to help agencies. For example, it has developed a workforce planning model and has launched a website to facilitate information sharing about workforce planning issues. OMB has played a more limited role; however, OMB's role in setting governmentwide management priorities and defining resource allocations will be critical to inducing agencies to integrate strategic human capital into their core business processes. Toward that end, OMB's current guidance to agencies on preparing their strategic and annual performance plans states that the plans should set goals in such areas as recruitment, retention, and training, among others. Earlier this month, OMB instructed agencies to submit a workforce analysis to it by June 29, 2001. The analysis is to include summary information on the

[13] *The Floyd D. Spence National Defense Authorization Act for Fiscal Year 2001*, P. L. 106-398, Oct. 30, 2000.

demographics of the agencies' permanent, seasonal, and temporary workforce; projected attrition and retirements; an evaluation of workforce skills; expected changes in the agency's work; recruitment, training, and retention strategies being implemented; and barriers to maintaining a high-quality and diverse workforce. The information developed may prove useful in identifying human capital areas needing greater attention.

Conclusion

Over the past decade, federal spending patterns changed, the federal workforce declined, and new contracting vehicles and techniques were introduced. Consequently, the current environment in which the government acquires services is significantly different than the one it operated under in 1990. However, the government's long-standing difficulties with managing service contracts have not changed, and it is clear that agencies are not doing all they can to ensure that they are acquiring services that meet their needs in a cost-effective manner.

The increasing significance of contracting for services has prompted—and rightfully so—a renewed emphasis by Congress and the executive agencies to resolve long-standing problems with service contracts. To do so, the government must face the twin challenges of improving its acquisition of services while simultaneously addressing human capital issues. One cannot be done without the other. Expanding the use of performance-based contracting approaches and emphasizing strategic human capital planning are welcomed and positive steps, but sustained leadership and commitment will be required to ensure that these efforts mitigate the risks the government currently faces when contracting for services.

Mr. Chairman, this concludes my prepared statement. I will be happy to respond to any questions you or other Members of the Subcommittee may have.

Contact and Acknowledgement

For further information, please contact David E. Cooper at (202) 512-4841. Individuals making key contributions to this testimony included Don Bumgardner, Ralph Dawn, Tim DiNapoli, Julia Kennon, Gordon Lusby, Monty Peters, Ron Schwenn, and John Van Schaik.

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